TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE

FISCAL MEMORANDUM

SB 322 – HB 291

March 16, 2015

SUMMARY OF ORIGINAL BILL: Requires the Commissioner of the Department of Economic and Community Development (ECD), in consultation with the Commissioner of the Department of Revenue (DOR), to conduct a review of franchise and excise (F&E) and sales and use tax credits codified under Tenn. Code Ann. §§§ 67-4-2009, 67-4-2109, and 67-6-224. Requires the review to evaluate the previous four fiscal years and to include a recommendation to modify, discontinue, or take no action with respect to each credit. Requires a report of the findings and recommendations to be prepared and submitted to the Governor, Speakers of the Senate and House of Representatives, and the Finance, Ways and Means committees of both houses, by January 15, 2017, and every four years thereafter.

Establishes an expiration date of July 1, 2015, for the following tax credits and incentives; provided that a taxpayer shall continue to be eligible for such credits or incentives if the taxpayer has filed a business plan with the DOR prior to July 1, 2015:

1) The industrial machinery F&E tax credit, equal to one percent of the purchase price of industrial machinery, for a general partnership that operates a call center in Tennessee that would otherwise qualify for the job tax credit;
2) The F&E job tax credit referenced above in 1. for a general partnership;
3) The one-time and six annual F&E tax credits in the amount of 1.75 percent of the investment (a minimum investment of $100,000,000) in the qualifying environmental project to eliminate mercury from the manufacturing process and operations of one or more existing chlor-alkali manufacturing and ancillary facilities and equipment in the state;
4) The F&E tax credit equal to 50 percent of the purchase price of brownfield property purchased in Tennessee for the purpose of a qualified development project;
5) The authorization for any airline company that has established its headquarters in Tennessee and has met the requirements to qualify for the qualified headquarters facility credit codified under Tenn. Code Ann. § 67-6-224, to convert any unused job tax credit or additional annual credit into a refundable credit, discounted to net present value;
6) The F&E tax credit equal to any qualified headquarters facility relocation expenses incurred by a taxpayer who meets the established job creation and wage level or job creation and capital investment criteria;
7) The franchise tax credit for a taxpayer that has established its headquarters in Tennessee and has met the requirements to qualify for the qualified headquarters facility credit codified under Tenn. Code Ann. § 67-6-224, equal to 6.5 percent of any net operating loss incurred by the taxpayer during the tax year, and awarded only if the taxpayer is

unable to use the loss or loss carryover to offset net income during the current tax year for excise tax purposes;

8) The green energy F&E tax credit for a certified green energy supply chain manufacturer and campus affiliate, integrated customer or integrated supplier of a green energy supply chain manufacturer, equal to the amount by which the charge for electricity sold to such an entity exceeds the charge that would have been made for such total delivered electricity if the maximum certified rate had been applied during the applicable tax year;
9) The carbon charge F&E tax credit for a certified green energy supply chain manufacturer and campus affiliate, equal to any carbon charges incurred by or imposed directly on such an entity, or imposed on the Tennessee Valley Authority or other applicable energy provider and billed to the certified green energy supply chain manufacturer or campus affiliate during the applicable tax year;
10) The F&E tax credit equal to any qualified medical trade center relocation expenses incurred by the key tenant, limited to a maximum of $10 per square foot of space within the facility that is leased and occupied by the key tenant;
11) The F&E tax credit equal to 15 percent of any qualified advertising expenses incurred for the purpose of co-promoting a qualified medical trade center and the State of Tennessee or the City of Nashville;
12) The program pursuant to which buildings, facilities, or other infrastructure may be developed utilizing a state funding mechanism and pursuant to which the value of tax credits that have been earned by the taxpayer but remain unutilized may be applied, in lieu of payments, toward the purchase or lease of such property; and
13) The sales and use tax credit for a taxpayer that establishes a qualified facility to support an emerging industry or a major cultural attraction in Tennessee, equal to all the state sales and use taxes paid to the state, except at the rate of 0.5 percent, on the sale or use of qualified tangible personal property.

Expands the definition of “industrial machinery”, for the purposes of sales and use tax exemption and F&E tax credits, to include machinery, apparatus, and equipment with all associated parts, appurtenances, and accessories, including hydraulic fluids, lubricating oils, and greases necessary for operation and maintenance, repair parts, and any necessary repair or taxable installation labor therefor, that is necessary to, and primarily for, the purpose of research and development.

Expands the definition of a “qualified business enterprise” to include an enterprise in which the business has made the required capital investment to permit the creation or expansion of back office operations. Establishes that, to qualify as a “qualified job” for the purposes of F&E tax credits, a back office operations position must have a wage equal to or greater than the state’s average occupational wage.

Deletes the requirement that, to qualify as a “qualified job”, the job position must be filled prior to January 1, 2016.

Authorizes the headquarters facility F&E tax credits to be claimed for only a taxpayer's sole international or sole national headquarters, instead of international, national, or regional headquarters.

Deletes the provision establishing that an integrated supplier or an integrated customer qualify for the additional annual F&E tax credit of $5,000 per qualified job, regardless of the level of its capital investment or the number of jobs created. Deletes the definitions of an integrated supplier or an integrated customer from the F&E tax provisions.

FISCAL IMPACT OF ORIGINAL BILL:

Decrease State Revenue – Net Impact – $2,741,600/FY15-16
Exceeds $4,441,600/FY16-17 and Subsequent Years

Forgone State Revenue – Exceeds $10,000/FY15-16 and Subsequent Years

Decrease Local Revenue – $1,293,800/FY15-16 and Subsequent Years

Forgone Local Revenue – Exceeds $5,000/FY15-16 and Subsequent Years

The Governor's FY15-16 proposed budget recognizes a total recurring decrease in state revenue from the General Fund in the amount of $4,600,000.

IMPACT TO COMMERCE OF ORIGINAL BILL:

Decrease Business Expenditures – $4,035,400/FY15-16
Exceeds $5,735,400/FY16-17 and Subsequent Years

Jobs Impact – Exceeds 100/FY15-16
Exceeds 1,000/FY16-17 and Subsequent Years

SUMMARY OF AMENDMENT (004375): Deletes the word "sole" wherever it appears in Section 19 of the original bill, which now, as amended, authorizes the headquarters facility F&E tax credits to be claimed for only a taxpayer's international or national headquarters, instead of international, national, or regional headquarters. Establishes that any taxpayer that has filed an application and business plan as a regional headquarters with the Department of Revenue prior to July 1, 2015, shall continue to be eligible for the F&E tax credit.

FISCAL IMPACT OF BILL WITH PROPOSED AMENDMENT:

Unchanged from the original fiscal note.

Assumptions for the bill as amended:

- The Department of Revenue confirms that any taxpayer that has filed an application and business plan as a regional headquarters prior to July 1, 2015 would continue to be eligible for the tax credit, even in the absence of the proposed amendment.
- Establishing an expiration date of July 1, 2015, for the tax credits described in 1) through 5) and 7) through 13) will not result in a significant state or local government fiscal impact as the number of taxpayers expected to qualify for these credits in future years and the amounts of the expected tax expenditures under current law is estimated to be not significant.
- Based on the Department of Revenue's (DOR) analysis of headquarters facility relocation expenses F&E tax credit, as described under 6), given to qualified taxpayers during the time period that this credit has been available, it is estimated that establishing an expiration date of July 1, 2015, for the credit will result in a recurring increase in state revenue of approximately $1,000,000.
- Expanding the definition of "industrial machinery", for the purposes of sales and use tax exemption and F&E tax credits, to include machinery, apparatus, and equipment necessary for operation and maintenance, repair parts, and any necessary repair or taxable installation labor therefor, that is necessary to the purpose of research and development, is estimated to result in a recurring decrease in state revenue of approximately $3,640,300 ($3,170,390 sales tax revenue; $469,910 F&E tax revenue) and a recurring decrease in local sales tax revenue of approximately $1,293,800. In addition, the amount of recurring forgone state revenue from an increase in research and development sales that would not occur without the passage of this bill is estimated to exceed $10,000; the amount of recurring forgone local revenue is estimated to exceed $5,000.
- Expanding the definition of a "qualified business enterprise" to include an enterprise in which the business has made the required capital investment to permit the creation or expansion of back office operations, for the purposes of F&E tax credits, is estimated to result in a recurring decrease in state revenue of approximately $481,300. This estimate is based on the assumption that the proposed expansion will result in 17 additional businesses qualifying for a median amount of job tax credit used over the previous three tax years ($28,312).
- Deleting the requirement that, to qualify as a "qualified job" for F&E job tax credit purposes, the job position must be filled prior to January 1, 2016, effectively extends F&E job tax credits to qualified jobs created after January 1, 2016.
- The total amounts of job tax credits awarded, including the additional annual job tax credits for Tier 2 and Tier 3 enhancement counties and the additional annual job tax super credits, were approximately: $43,078,000 in FY11-12, received by 384 companies; $47,282,000 in FY12-13, received by 396 companies; and $42,329,000 in FY13-14, received by 334 companies.
- The three-year average amount awarded is approximately $44,230,000; the three-year average number of taxpayers receiving such credits is approximately 371; the three-year average tax credit per company is estimated to be approximately $119,218 ($44,230,000 / 371).
- The effectiveness of job tax credits and their impacts on job creation is unknown and dependent on multiple unknown factors. However, it is a generally accepted notion that

at least a small percentage of jobs for which such tax credits are awarded would still be created in the absence of such tax credits.

- Using assumptions of 350 companies receiving an average of $100,000 in tax credits per year, and assuming that such tax credits are awarded to at least five percent, or 17, of companies that would have expanded and created jobs in the absence of the tax credits, extending the F&E job tax credits to jobs created after January 1, 2016, is expected to decrease state revenue, revenue that would be collected under current law, in an amount that exceeds $1,700,000 per year. This decrease is expected to be first incurred in FY16-17.
- Based on DOR's analysis of qualified headquarters facility tax credit given to regional headquarters over the previous three fiscal years, authorizing the headquarters facility F&E tax credits to be claimed for only a taxpayer's international or national headquarters, instead of international, national, or regional headquarters, is anticipated to result in a recurring increase in state revenue of approximately $380,000.
- Deleting the provision establishing that an integrated supplier or an integrated customer qualify for the additional annual F&E tax credit of $5,000 per qualified job, regardless of the level of its capital investment or the number of jobs created, and deleting the definitions of an integrated supplier or an integrated customer from the F&E tax provisions, is not expected to result in a significant state or local fiscal impact. The number of taxpayers that have previously qualified for this tax credit and the total amount of tax credits awarded is considered to be not significant.
- The net decrease in state revenue is estimated to be $2,741,600 ($3,640,300 - $1,000,000 + $481,300 - $380,000) in FY15-16, and estimated to exceed $4,441,600 ($2,741,600 + $1,700,000) in FY16-17 and subsequent years. The recurring amount of forgone state revenue is estimated to exceed $10,000, beginning in FY15-16.
- The net decrease in local revenue, beginning with FY15-16, is estimated to be $1,239,800. The recurring amount of forgone local revenue is estimated to exceed $5,000, beginning in FY15-16.

IMPACT TO COMMERCE WITH PROPOSED AMENDMENT:

Unchanged from the original fiscal note.

Assumptions for the bill as amended:

- Based on the assumptions above, the proposed legislation as amended is expected to decrease business expenditures in the amounts of $4,035,400 ($2,741,600 + $1,293,800) in FY15-16, and an amount exceeding $5,735,400 ($4,441,600 + $1,293,800) in FY16-17 and subsequent years.
- It is further estimated that deleting the sunset provision for F&E job tax credits will incentivize some companies to create jobs that would not otherwise be created under current law, beginning with FY16-17.
- If we estimate that at least 50 companies will qualify for an average job tax credit of $100,000, and that the average job tax credit for each job is equal to $5,000, the total number of jobs created as a result of the proposed legislation as amended is estimated to

exceed 1,000 [(50 x $100,000) / $5,000], beginning with FY16-17. The number of jobs created in FY15-16 due to additional tax incentives provided for research and development and back office jobs is estimated to exceed 100.

- Any secondary impacts on commerce and jobs are dependent upon multiple unknown factors and cannot be quantified with reasonable certainty.

CERTIFICATION:

The information contained herein is true and correct to the best of my knowledge.

Jeffrey L. Spalding, Executive Director

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